

18 October 2023

Mr Adam Hawkins
Assistant Secretary
Retirement, Advice and Investment Division
Treasury
Parkes ACT 2600

Dear Mr Hawkins

RE: Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023

The Financial Services Council (FSC) welcomes the opportunity to provide comment in relation to exposure draft legislation to introduce a new tax on individuals whose total superannuation balance is over \$3m. The FSC wishes to highlight a number of areas where we request additional consideration to improve the administrative efficiency of the regime and provide certainty for individual taxpayers.

Absent the considerations below being addressed we would therefore not support the legislation being introduced into the parliament. Specifically:

1. The lack of indexation of the \$3 million threshold is not supported and intergenerationally unfair. Leaving the decision of when and if to index the \$3 million threshold to a future Government does not provide superannuation consumers and the industry with sufficient certainty, and is not consistent with sound long-term superannuation taxation policy. At a minimum, the threshold should be subject to periodic review to ensure it remains appropriate.
2. The current calculation approach will lead to the taxation of unrealised capital gains, which we believe is bad policy that will impact a range of individuals with illiquid assets. We note that other features of the tax system, not just the superannuation tax settings, have encouraged individuals to put illiquid assets such as their business premises or farm into their superannuation, including the small business capital gains tax concessions. The legislation should be amended so that a deemed rate of return is applied – this would be administratively simpler, avoid the taxation of unrealised capital gains, and ensure equal treatment across all superannuation fund structures and investment portfolios.
3. We note that this change is retrospective in that it applies a new tax to superannuation balances that were built up under previous tax settings. We believe it would be appropriate and fair to provide impacted individuals the option of transferring their assets outside of the superannuation system without incurring any tax impacts via a condition of release. This would also allow a number of impacted individuals including farmers and small businesspeople to re-arrange their affairs to avoid being unfairly taxed on unrealised gains and the undue liquidity stress that would arise from needing to funds such a unprecedented tax liability. Appropriate tax relief may also be required from state governments.
4. We note that it is somewhat challenging to provide meaningful feedback on the proposed policy for this measure when significant elements of the design, including modifications to withdrawals and contributions totals and valuation methods for superannuation interests, will be set out in regulations yet to be issued. Given the policy is scheduled to commence 1 July 2025, we believe there is ample time for the Government to provide the full regulations so the parliament can assess the total impact of this policy change.
5. It is not clear the proposed implementation approach will minimise additional reporting processes on APRA-regulated funds and avoid the creation of bespoke processes and calculations utilised by few if any members. More work is required to ensure a targeted low-cost reporting solution for the proposed measure to minimise the cost burden ultimately borne by superannuation consumers. Clarity on the implementation approach should be provided in the final explanatory memorandum.

6. Progressing other related measures in parallel – in particular, to permit the conversion of existing legacy products into more modern products, would also be welcome.

Our specific feedback is attached in Appendix 1: Specific feedback on the exposure draft legislation.

If you would like to discuss or have any questions arising from our submission, I would be happy to assist further.

Yours sincerely

Spiro Premetis
Executive Director – Policy and Advocacy
Financial Services Council

Appendix 1: Specific feedback on the proposed measure

Aspect of proposed measure	FSC Comments and Recommendation
<p>No Indexation of the \$3 million threshold</p>	<p>The FSC recommends indexing the \$3m threshold so that it retains its real value over time.</p> <ul style="list-style-type: none"> In our view, there are genuine questions around the future interaction this unindexed threshold has with the indexed transfer balancer cap threshold. These interaction questions are best resolved as part of this phase of the policy design, and not left as a matter for future Governments. Leaving the decision of when and if to index the \$3 million threshold to a future Government does not provide superannuation consumers and the industry with sufficient certainty and is not consistent with sound superannuation taxation policy. Ideally, these settings would promote public confidence in the superannuation system over the medium to longer term. Not indexing the \$3 million threshold undermines this broader objective. <p>As a simpler alternative, the FSC supports and recommends withdrawal of balances above the \$3m threshold as a one-off process (with appropriate relief provided to facilitate such a process) which would mean the indexation of the threshold would no longer be an issue. At a minimum, the threshold should be subject to periodic review to ensure it remains appropriate.</p>
<p>No change to Preservation Rules</p>	<p>The FSC recommends the Government explore the possibility of changing existing preservation rules for members who have a balance above \$3m but are currently unable to withdraw as they do not currently meet a condition of release. This will allow individuals of all ages who would otherwise be subject to the additional tax to withdraw amounts in excess of the threshold.</p> <p>Fund members who have not met a condition of release will be subject to a tax increase with no way to reverse their previous contribution decisions. They contributed to superannuation under rules in place at the relevant time and will now be subject to different rules in relation to the taxation of those benefits within the fund.</p> <p>If this change does not occur, some would perceive the measure to incorporate an element of retrospectivity – people have made additional contributions to their superannuation on the basis of certain tax rules remaining as is i.e., these rules are now changing with no opportunity for those individuals who have not met a condition of release to withdraw these additional contributions.</p> <p>In addition, the FSC recommends amending the tax laws to provide a time-limited amnesty (transition period) for those individuals aged less than 60 to permit the tax-free withdrawal of benefits due to this change in law. Currently, those under preservation age would be paying tax of 22 per cent (including Medicare levy) on the taxable component, while those that have reached preservation age and are under the age of 60 would be pay tax of 17 per cent (including Medicare levy) for amounts above the low-rate cap amount (currently \$235,000 for the 23/24 FY).</p>

Aspect of proposed measure	FSC Comments and Recommendation
<p>Taxation of unrealised capital gains</p>	<p>Taxation of unrealised gains is a flawed policy, and an unacceptable precedent that the FSC does not support.</p> <p>Tax on unrealised gains can create significant cashflow issues within the fund. This is because when tax is levied on a position not realised to cash but nevertheless payable in cash it may force actual realisation of assets to fund the payment of the tax. The CGT system would also need to be overhauled because under the current CGT system taxing unrealised gains would reset the cost base for future years calculation purposes such that the cost base for all fund assets would need to be re-based annually. Additional complications would arise on the management of corporate actions (that already affect the cost base adjustments). Such corporate actions include capital returns, tax deferred, and fee distributions. It is not clear how they may need to be treated differently between members below or above the \$3m.</p> <p>Applying a deemed rate of return determined by formula on the closing superannuation balance each year could be an attractive solution to implementing the proposal because there is:</p> <ul style="list-style-type: none"> • No need for a formula which adjusts for contributions and withdrawals through the use to calculate notional earnings (not actual earnings); • No additional reporting required by any superannuation funds or changes to the MAAS/MATS reporting for APRA funds; and • Deemed earnings requires less attention to maintain over time and would be more consistent to the necessary approach required for defined benefit interests. <p>If this approach is accepted, then industry and Treasury could focus on examining a reasonable benchmark or basis for determining the deemed earnings rate. This simplicity would allow time and effort to consider things like long term averages of actual returns. A deemed rate would also not require the taxation of unrealised capital gains and could preserve the CGT discount inherent in actual investment returns. For example, these rates could be calculated on a rolling average basis and easily changed to consider current/expected investment market volatility if need be. This alternative method would satisfy the three policy objectives of minimising compliance costs, reducing complexity and ensuring sector neutrality. The FSC recommends the Treasury to explore the alternative policy solution of using a deemed earnings rate.</p>
<p>Time allowed to pay Div 293 tax</p>	<p>If the Government proceed with an approach of taxing unrealised gains, and not providing an amnesty then more time should be allowed to pay Div 293 tax (currently 84 days proposed), particularly if an illiquid asset is involved (e.g. the sale of a rural or commercial property).</p>

Aspect of proposed measure	FSC Comments and Recommendation
<p>Total super balance and adjustment items</p>	<p>We're pleased to see that there are more detailed adjustment items within the concept of an adjusted total super balance for this measure. However, there are some concerns with:</p> <ul style="list-style-type: none"> • The adjustments for release authorities (RAs) particularly with excess non-concessional contributions (ENCC) under proposed s296-50(1)(e). If you add back RAs under an excess non-concessional contribution situation, there is a potential for double taxation. Associated earnings are already part of the ENCC regime which the individual pays tax on. Then this is added back to the Adj TSB which could mean the individual is over the \$3m and pay additional tax on the associated earnings they had already paid tax on. We also note that an exception is provided for FHSS withdrawals to preserve tax concessions for associated earnings. • Approach taken with continuous disability policy payments should be adjusted so that continuous disability policy amounts are included in the definition of contribution and included as a withdrawal if paid from the fund. Currently these are excluded from withdrawals and contributions. This approach means they will net one another off, which works to the extent the insurance benefit is paid from the fund. If the insurance benefit is retained in the fund, it will be included as earnings, which would incorrectly inflate this figure, consistent with the fact death or TPD insurance would inflate earnings without it being excluded from being a contribution.
<p>ATO Reporting for calculation purposes</p>	<p>The legislation does not make clear how the ATO will administer and implement the proposal to reduce the compliance burden ultimately born by members.</p> <p>The FSC strongly supports and recommends a simple manual reporting solution to minimise the cost impact of implementing the measure for impacted and otherwise unaffected individuals. We would have significant concerns if instead full comprehensive reporting on all individuals in the superannuation system was the approach taken by the ATO for a measure the Government argues will only impact 80,000 individuals.</p> <p>We note that it is critical that the compliance burden and cost to super funds, and ultimately members, of implementing this measure is minimised by ensuring administration and reporting solutions are targeted, simple and manual so far as this is practicable.</p> <p>A manual solution still remains the most appropriate solution, however progressing with the deemed earnings rate would remove most of this complexity and cost. Treasury's own analysis indicates less than 0.5% of superannuation account holders would be captured under BTSC, and the cost to industry participants to uplift MAAS/MATS and SuperStream for such a small population is prohibitive.</p>

Aspect of proposed measure	FSC Comments and Recommendation
	<p>The manual process should only require superannuation funds to provide data, when notified by the ATO, for account holders the ATO has identified as likely to have a total super balance in excess of \$3m. Any subsequent release authorities should rely on the existing paper-based process.</p>
<p>Carry forward negative super earnings</p>	<p>Given the unusual approach adopted by Government in the taxation of unrealised capital gains, the FSC welcomes the Government permitting impacted individuals to carry forward of capital losses.</p> <p>We seek clarity on the following points:</p> <ul style="list-style-type: none"> • Will an individual have to keep track of their negative carry forward earnings, or will this be displayed and reported on an ATO portal of sorts like MyGov? Our expectation is that the ATO will record and make these details available via individual's MyGov account • Under proposed s296-110 if an individual has unapplied transferrable negative superannuation earnings for an income year and has a TSB greater than \$3 million either immediately before the start or at the end of that same income year, they are eligible to recalculate their superannuation earnings by applying their unapplied transferrable negative superannuation earnings. If the individual is eligible to recalculate, do they have to apply for this, or is it done automatically by the ATO under s296-110 ITAA 1997? It reads under the section that it is automatically done. <p>Unapplied transferable negative superannuation earnings: To ensure fairness and equal treatment with respect to the ability to utilise unapplied transferable negative superannuation earnings, we recommend allowing a refund of this amount on exiting the superannuation system, including on death of the member.</p>
<p>Tax payable items</p>	<p>Release Authority process. We note that the individual has 60 days to make an election on how they want to settle their tax liability, and while this legislative consultation doesn't deal to the administrative process, we are interested on how the release authority mechanism will take place. Release Authorities are automated via SuperStream under the Rollover MIG and currently, there are specific RA codes including FHSSS, ECC, ENCC, ENCCT, Div293 or DivDef.</p> <p>The ATO should as part of the consultation on the administrative design of the solutions and reporting to support this measure clarify their implementation approach.</p>

Aspect of proposed measure	FSC Comments and Recommendation
Treatment of disability or terminal illness insurance proceeds	<p>To ensure members are treated equally, the same treatment should apply with respect to structured settlement (personal injury) contributions and disability or terminal illness insurance proceeds. The exposure draft Bill provides, at Schedule 1, item 15, section 296-25 of the ITAA 1997, that a person is not liable to pay Division 296 tax for an income year if a structured settlement contribution was made for them in that year or any earlier income year.</p> <p>An equivalent exception should apply where disability or terminal illness insurance proceeds have been paid to a person's superannuation.</p> <p>To be able to make a structured settlement contribution an individual needs to have a medical condition that is almost identical to the permanent incapacity condition of release. Those that meet this medical definition will often have higher ongoing medical and care expenses irrespective of whether they've received a settlement (or have disability insurance). To ensure equal treatment for those that have such a serious medical condition, we suggest replacing the exemption for those who make structured settlement contributions to those that satisfy the permanent incapacity condition of release. In this scenario, consider imposing an age limit as it would be quite easy to satisfy the permanent incapacity definition later in life. Suggest limit the exemption to those that meet the requirement by 75 (this would be consistent with the proposal regarding structured settlement contributions that need to be made by the 28th day after the month the member turns 75).</p>
Tax liability arises on or after a persons death	<p>The exposure draft Bill provides, at Schedule 1, item 15, section 296-30 of the ITAA 1997, that a person is not liable to pay Division 296 tax for an income year (first year) if they die before the last day of the year. In limited circumstances, such as delays due to litigation, a superannuation death benefit could remain unpaid for more than 12 months. If the death benefit is paid from their superannuation interest in the following income year (second year) no Division 296 tax liability should arise because the deceased's TSB would be nil. However, if the death benefit is unable to be paid until the third income year, it appears that a Division 296 tax liability would apply for this income year. We suggest the intended operation of this exception is clarified and any necessary modifications are made to ensure no tax liability arises on or after a person's death.</p> <p>This exception also states that it applies where the individual died 'before the last day of the year'. We suggest modifying the law to cater for the situation where someone dies on the last day of the year.</p>
Treatment of insurance proceeds	<p>The exposure draft Bill provides, at Schedule 1, item 15, section 296-55(1)(e)(ii) of the ITAA 1997, that the amount of a benefit that is payable because of the happening of a contingency dependent on the termination of the life of the person is included in a person's contributions total. It is not clear what types of payments are intended to be captured by s 296-55(1)(e)(ii) and as such we suggest this is clarified in the final legislation and/or explanatory material. We note that terminal illness insurance proceeds should be included in a person's contributions total however if s 296-55(1)(e)(ii) intends to refer to terminal illness insurance proceeds, the provision could be removed considering the only types of insurance benefits available through superannuation are payable because of death, TPD or terminal illness.</p>

Aspect of proposed measure	FSC Comments and Recommendation
<p>Roll-over superannuation benefit</p>	<p>Additional issues we found in the legislation are as follows:</p> <p>s296-50(1) provides that the following amounts are counted in an individual's withdrawals total:</p> <ul style="list-style-type: none"> the amount of a contributions-splitting superannuation benefit rolled-over, transferred or allotted for the benefit of another person during the year from a superannuation interest of yours; the amount of a family law superannuation payment made to another person during the year because a superannuation interest of yours is subject to a payment split <p>However, s296-50(5)(a) then provides that an individual's withdrawals total does not include the amount of a roll-over superannuation benefit.</p> <p>A contribution splitting superannuation benefit or family law super payment that is rolled from one superannuation fund to another presumably falls within the definition of a roll-over superannuation benefit (s306-10 of ITAA97). Assuming this is the case, such a benefit would seem to be specifically intended to be included in an individual's withdrawals total under s296-50(1) but appears to then be removed from the withdrawals total by s296-50(5)(a).</p> <p>A similar issue occurs with s296-55(1) and s296-55(3)(a).</p>
<p>Other related measures</p>	<p>In parallel with this additional tax measure that is proposed to commence on 1 July 2025, the FSC supports and recommends implementation, subject to consultation, of the previously announced but unenacted measure to allow individuals to move out of legacy retirement products into modern products (announced in the 2021–22 Federal Budget).</p> <p>The FSC supports the previous Government's announcement to exclude amounts allocated from a reserve supporting the legacy pension from the concessional contributions cap. However, the FSC does not support the previous Government's proposal to tax the allocation from the reserve at 15 per cent as it does not take into account that the monies held in these reserves are not exempt current pension assets and so have already had 15 per cent tax paid on them. Such taxation will result in a loss of capital for these act as a deterrent for those wishing to leave these legacy products.</p>